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TAGS: [EFIN](#) [ECON](#) [IZ](#)
SUBJECT: MINISTRY OF FINANCE CONSIDERS USD 5 BILLION BOND
ISSUANCE

REF: A. BAGHDAD 244
[1](#)B. 08 BAGHDAD 3417

[1](#)1. (SBU) Summary: Iraq's Ministry of Finance (MoF) is considering a new bond issue worth USD 5 billion in order to better manage its cash-flow in the face of reduced oil export revenue. Demand for the T-bills offered at price-capped auctions is "variable," with two state-owned banks accounting for most purchases. There is no secondary market for the GOI's dinar T-bills, though the MoF would like to see one develop. End summary.

State-Owned Banks Hold Majority of T-Bills Issued

[1](#)2. (SBU) According to Ministry of Finance Director General for Debt Management Mowafak Taha Izzedin, the MoF currently issues dinar-denominated T-bills through the Central Bank of Iraq (CBI), twice a month. Auctions are announced by the CBI one week in advance. Any bank registered in Iraq is permitted to participate in these auctions. Given the size of their assets and orders from the MoF, Iraq's two largest state-owned banks, Rafidain and Rasheed, are the two main purchasers of these T-bills. According to Mowafak, they have purchased roughly 65 percent of all T-bills sold. State-owned banks are not obligated to purchase T-bills, but they are "encouraged" to do so. The Agriculture and Real Estate banks, also state-owned, make their bond purchases through Rasheed or Rafidain. Treasatt, Econoff, and Treasury OTA Advisors met with Mowafak on February 5, in response to a Minister of Finance request (ref A) to assist the GOI's efforts to expand its government bond markets.

[1](#)3. (SBU) The Minister of Finance has announced that the MoF would like to issue up to USD 5 billion in new dinar T-bills to diversify the sources of funds available for government expenditure. However, Mowafak noted that there might not be enough demand, or sufficient liquidity in the private banks, to meet increased supply. He did allow that private customers, including non-residents, could open bank accounts and direct the bank to invest its funds in the T-bill market. (Comment: Were the MoF to allow bond yields to move with market conditions, demand would meet supply as private banks, such as al-Warka (ref B), seek more deposits. End comment.)

No Secondary Market for T-Bills

[1](#)4. (SBU) Mowafak said that demand for MoF T-Bills is "variable." On occasions the offer is oversubscribed. At other times, the MoF may only sell 30-75 percent of an offering. Interest offered on these T-Bills during the auction has ranged from 14 to 21 percent. If the MoF determines that the interest rate is too high, it has the right, which it has exercised, to cancel the auctions. Both the Rasheed and Rafidain Banks have complained that the CBI-imposed 75 percent reserve requirement ratio on funds deposited by the government for GOI spending means that they

have fewer funds to purchase T-bills. (Note: Earnings on these deposits are an important source of revenue for the state-owned banks. Both CBI and MoF officials point out, however, that the bulk of the deposits in state-owned banks (57 percent) belong to the GOI and are ill-suited for investment purposes. End Note.)

15. (SBU) Only banks are allowed, under Iraqi law, to purchase government T-bills. Banks may sell T-bills to another Iraqi bank, but beyond the banks there is no secondary market. The MoF is open to the idea of allowing private individuals or entities to purchase government T-bills, but it has encountered resistance from Rasheed and Rafidian Banks. These banks argue that their customers would move funds out of their savings deposits to the detriment of the banks. Ministry of Finance T-Bills have a 91-day maturity. The MoF is considering longer-term bills, up to 183-days, but is concerned that these would be "too expensive," said Mowafak.

16. (SBU) On November 17, 2008, a Bearing Point-designed Government Security Registration System was implemented allowing the banks and MoF to handle the auction electronically. Prior to this automation, bond auctions were conducted in person at the CBI and were sometimes cancelled or postponed due to security issues.

Comment

17. (SBU) The basic laws and mechanisms are in place for a T-bill market but, as this conversation confirmed, the market is far from functional. A T-bill market should advertise

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regular auctions well in advance, and the auctions should clear at market prices. Such a market is attractive to investors. The MoF has been reluctant to develop the T-bill market since they have not needed money. However, later this year or, more likely, in 2010 they likely will need to tap other resources to mitigate a sharp downturn in revenues. The key is to develop a well-functioning T-bill market in advance so when they do need it, the market and investors will be ready.

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